FRAUDULENT CONVEYANCE LAW AND BANKRUPTCY.*

This case has attracted attention, not because of the difficulty or novelty of the questions but because offering opportunity for an epoch making opinion that will avert litigation by restoring the ancient landmarks. Hence its public interest may warrant briefly suggesting certain points considered by different counsel.

The first bankrupt law, Hen. 8th, 1547, aimed to prevent an insolvent trader from preferring friends, and parliament enacted equality quoad any property whereof the trader was possessed on, or after, the day when he committed the particular (crime) which his creditor set up as an act of bankruptcy—hiding from the sheriff, for example.

An insolvent could prefer at common law† and research will doubtless find that, subsequent to bankrupt laws, insolvents, who were not traders, did discriminate between creditors.

Parliament did not concern itself about equality prior to hiding from the sheriff; it was aiming to secure equality subsequent to the act which a creditor claimed was an act entitling him to bankrupt his insolvent debtor. Congress aimed to secure equality as to any property which the insolvent possessed within four months next preceding adjudication.

A conveyance with intent to hinder devests the grantor. Suppose a trader, not being insolvent, conveys his farm to B with intent to hinder, and many years later hides from the sheriff. This conveyance, having been made *before* the grantor hid from the sheriff, was not void under ancient bankrupt statutes although it was void, as to creditors under 13 Eliz.‡ It is easy to see why the creditors of this trader could attack this conveyance, but it is difficult to see why his trustee in bankruptcy could attack it. Strange to say, considerable research failed to suggest the ancient theory on which the trustee filed his bill against the

*Moore *v.* Tearney, 62 W. Va. 72, 57 S. E. 263; In re Hurst, Fed. Reporter, Sept. 28, 1911, and Number 1068, C. C. A., Fourth Circuit. Continued from February Register (see vol. XVII, p. 737).

†Wilson *v.* Forsyth, 24 Barb. A well-considered opinion by Judge Strong.

‡Observe, till 13 Eliz. the intent to hinder did not make a deed void unless damage resulted. If the grantor had two farms, the intent did not vitiate if one farm would pay the creditor.

grantee, but he did file it and the Chancellor ordered the fraudulent grantee to convey the farm to the bankrupt's trustee. Conrade de Gols, Assignee of Ward, a bankrupt, *v.* Jones, 4 Parl. Cases, A. D. 1737.

Our bankrupt act, § 70 says: The trustee of the estate of the bankrupt shall be vested with the title of the bankrupt, as of the date of adjudication, to all property transferred by him in fraud of creditors. And the question comes, what title did the bankrupt have if he had conveyed prior to the four months? But the law is now settled:

(1) That congress intended to secure equality commencing four months before bankruptcy. The trustee takes any right or title which was in the bankrupt at the date of adjudication. Preferential transfers, etc., being nullities, if within the four months, the bankrupt has, except as to such transfers, etc., whatever title he had when the four months commenced.

(2) That congress did not intend to disturb rights which had vested, under state law, prior to the four months. If, prior to the four months, the bankrupt had made a conveyance which was valid as to all creditors, except one, then this one creditor could assert a right which no other creditor could.

Much confusion and many hasty opinions would have been escaped if, thirty years ago, some competent judge had said: "As to transactions within the four months the trustee stands in the shoes of the bankrupt and, as to transactions, prior to the four months, in the shoes of any creditor who could assert his demand if no bankruptcy." It seems safe to assume that a competent judge will speak thus if his intention be sufficiently arrested.

In re Cohn, quoted in 3 Remington 287, is radically wrong and invites a "recall," but it will be right if the words, "quoad ante-four months matter," be inserted. It will then read thus:

"The cardinal principle of the bankrupt act is to give creditors only those rights" (*quoad ante-four months matter*) "which would be theirs if bankruptcy had not supervened." It should be kept in mind that when competent judges say, "Bankrupt laws are passed to secure equality," they assume that lawyers will understand that they refer only to the "bankrupt's" estate as distinguished from the estate "in bankruptcy." The "bankrupt's" es-

tate refers to four months matter; the estate "in bankruptcy" refers to four months matter plus the rights of creditors as to matter prior to the four months.

While writing Keppel *v.* Tiffin Sav. Bank, 197 U. S. 356, 49 L. Ed. 790, Justice White never dreamed that any court would ever apply his reasoning to a conveyance which was six years before bankruptcy. He does not even take trouble to mention that he speaks exclusively to the fact that congress intended to secure equality commencing four months before bankruptcy. He does not even take trouble to distinguish the estate "in bankruptcy" from the "bankrupt's" estate. Justice Day does. Page 378. "In view of the purpose to make an equal distribution of the *bankrupt's* estate."

In this connection attention is called to two decisions. Simmons *v.* Greer, 174 Fed. 654, quoted in 3 Remington 348. The mortgage was prior to the four months and, while valid as to subsequent creditors, it was void as to pre-existing creditors. Held, that pre-existing took the fund to the exclusion of subsequent creditors. In re Hurst, 188 Fed. 707. The conveyance was six years prior to bankruptcy. The district court *seems* to assume that the conveyance, while valid as to Tearney, was void as to all other creditors, and yet Tearney could share in the fund.

The Questions Involved.

First question. Can a fraud-in-fact grantee-creditor share in the proceeds of sale?

Statement to illustrate question. A son owed his father $18,000 borrowed money and owed X, Y and Z $20,000, and had nothing except a $14,000 farm. Intending to defraud X, Y and Z this son conveyed his farm to his father and the father participated in the intent. The father purchased as a stranger and paid his son $14,000 cash. The $18,000 debt had no connection with his purchase. Thereupon X, Y and Z united as co-plaintiffs in a creditors' bill against the father asking the court to subject the farm to their debts: the court, having adjudged the conveyance void for fraud-in-fact, sold the farm for $14,000 and comes to distribute the proceeds of sale. Thereupon the father asks to prorate as to his $18,000 unconnected debt. X, Y, and Z contend that he cannot prorate for either of three reasons:

1. The conveyance was valid between grantor and grantee. It would open Pandora's box to upset the doctrine that a fraudulent deed is valid between parties. Ancient equity gave no relief except to remove the obstruction which hindered the creditor's elegit.

2. In West Virginia a fraudulent conveyance is set aside only as to the debts of attacking creditors.

3. The hands of a fraud-in-fact grantee are unclean as to the proceeds of sale.

It is worse than irrelevant to mention that the son used the purchase money to pay a debt for which his father was surety. It is irrelevant because the "agreed fact" is, that it was fraud-in-fact and there is no suggestion of any intent to make the father a preferred creditor. This grantee stands precisely as a stranger would stand who purchased with notice that his grantor conveyed with intent to hinder.

Again. It is irrelevant to mention that the $18,000 debt was "unconnected" with the purchase money: viz, unconnected with the consideration for the conveyance. The doctrine of unclean hands relates to the person, not to his debt. Fraud is personal. The owner of this debt was "connected with" the fraudulent intent. This is not like the case where a man sold two separate farms to the same person and conveyed one farm with intent to hinder, but conveyed the other farm with honest motive.

The precise question is, can a fraud-in-fact grantee share in the identical property which was the subject matter of his fraud? Does the doctrine of unclean hands apply to the debt as distinguished from the person?

Second question. If this father could not share when the state court distributes the proceeds of sale, can he share when they are distributed by the bankruptcy court, and when the fund represents a transfer made six years before bankruptcy?

Third question. Are creditors estopped by an inadvertence by the referee?

Statement to illustrate question. The estate in bankruptcy consisted of:

(a) Certain property, surrendered by the bankrupt, in which all could share, and

(b) A "right" (which all creditors, except one, had): to wit, a right to bring suit to recover a farm which the bankrupt had conveyed six years before bankrupting. This being the situation the referee, inadvertently, directed the trustee to bring suit "to avoid this conveyance as to all creditors who had proved debts," and the state court adjudged the conveyance void "as to the *rights* of the bankrupt's trustee."

(1) Is this an adjudication that the deed was void as to the grantee?

(2) Does the referee's direction to bring suit "for the benefit of all who prove debts," estop creditors from showing that the deed was not set aside as to the debt due to the fraud-in-fact grantee?

Fourth question. If a creditor misleads neighbors to credit a man whom he knows to be insolvent, can he prorate with the misled creditors?

Statement to illustrate question. The father, through inadvertence, mere negligence, did not record the deed for six years but permitted the son to remain in possession and hold himself out as owner whereby he was able to novate certain debts: viz, renew notes, and to incur new debts.

If the son has doubled his debts while holding himself out as owner:

(z) Is the burden on each creditor to prove that he gave credit because, and only because he supposed that the ownership of the farm had not changed?

(y) Is the burden on the father to show which one of a multitude was not misled?

(x) If the record does not distinguish the debts, incurred *before* the holding out, from the debts incurred, *during* the holding out, will the equity court make inquiry before prorating the fund with the father?

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